The Pizza inn inc.
1973 ANNUAL REPORT

TO THE SHAREOWNERS:

F. J. Spillman

For the second straight year your Company is proud to report new records for both revenues and net income. In 1973, The Pizza Inn, Inc. surpassed all previous sales and earnings records and has become a stronger and more vital factor in the food service industry. Revenues were up 46% to $21,288,031, and earnings before extraordinary items increased 75% to an all time high of $1,027,512, or .68 per share.

The Company's growth record reflects the performance of a growing organization serving growing markets and is the result of many factors, one of which is a stronger demand in the food industry for a restaurant that offers a convenient, family dining atmosphere and provides a quality product, all of which have become the trademark of Pizza Inn. Another factor is the continuity of management and the addition of new personnel which insures an efficient and effective operation.

In 1973 we expanded our operating units to 93 Company-owned and 168 franchised units. The combined sales of Company-owned and franchised units exceeded $55 million. In general, we continued to build a strong financial base in 1973. For more specific details, please refer to the other pages of this Annual Report where our significant operating and financial achievements are described.

Future prospects for your Company appear excellent, and in 1974 the Company and franchise owners anticipate expanding their present markets by opening new Pizza Inns

in various cities and towns throughout the United States, Mexico and Japan. Your Company anticipates opening 35 Company-owned units and franchisees have indicated they expect to open 70 new units in 1974.

The perspective for 1974 includes consideration of the energy crisis. Management is of the opinion that Sunday closings of service stations will have no significant impact upon the daily conduct of business or future expansion plans. Pizza Inn is a neighborhood concept evidenced by the fact that a majority of a store's customers will generally travel less than three miles to a Pizza Inn.

As we all are so aware, food prices increased an average of 20% or more in 1973, while menu prices in restaurants increased an average of 9.5%. It is becoming less expensive for the American family to eat away from home than it is to prepare at-home meals for family consumption.

We believe your Company's solid record of growth and financial stability will continue notwithstanding the possibilities of even higher interest rates, renewed inflationary cost pressures and uncertain effects of price controls in 1974. With inflationary trends continuing in our economy, your management has improved procedures to control costs. Arrangements have been made with various suppliers to insure availability of products should unforeseen shortages arise. As the Company's volume increases, our purchasing power increases and allows us to purchase larger quantities of goods at a reduction in cost. Increased storage space in newly-constructed Pizza Inns, better training of personnel, stringent portion controls, adherence to quality standards, and continued improvement of computer controls and weekly reports result in a more efficient operation.

The nationwide demand for away-from-home foods is expected to increase in 1974, and one of management's goals will be to acquire a larger share of the market. Your Company is dedicated to growth in the pizza market and will continue its expansion program during 1974; however, management will remain cognizant of the many changing factors in the economy and will continually strive to maintain and increase Pizza Inn's profitability. We believe 1974 will be another record breaking year for Pizza Inn.

We can achieve the high quality of service your Company strives to give its customers only through the efforts of our employees who individually perform these services. The record of your Company is a tribute to each of these employees and we take this opportunity to express our appreciation and acknowledge our awareness of a job well-done.

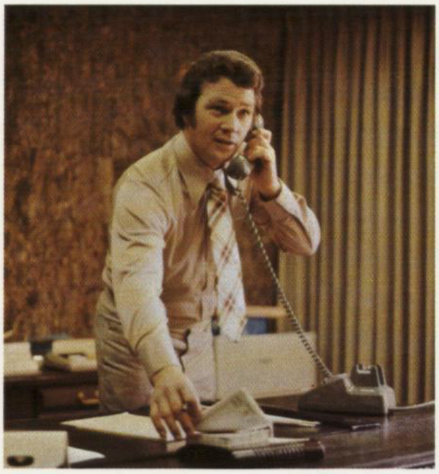
Respectfully,

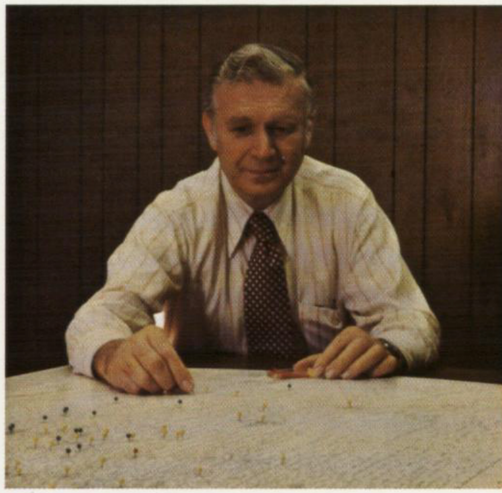
F. J. Spillman

F. J. Spillman
President
March 12, 1974

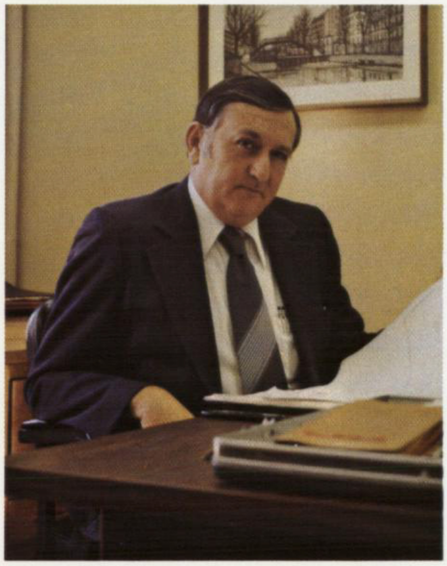
MANAGEMENT


George W. Wragg

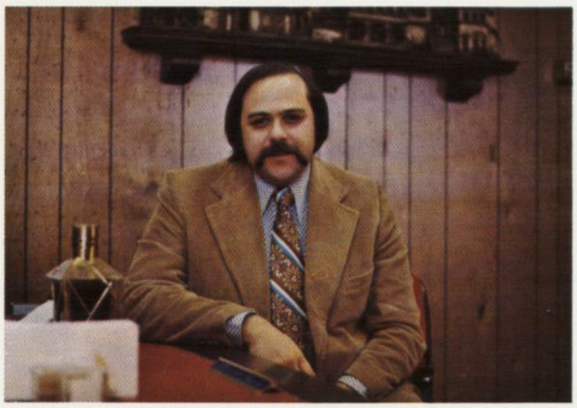

M. R. MaGouirk


Walter J. Sodeman

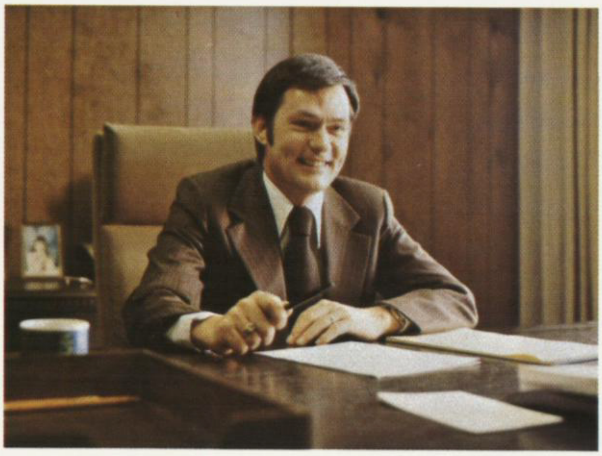

James A. Rozzell


James M. Phy

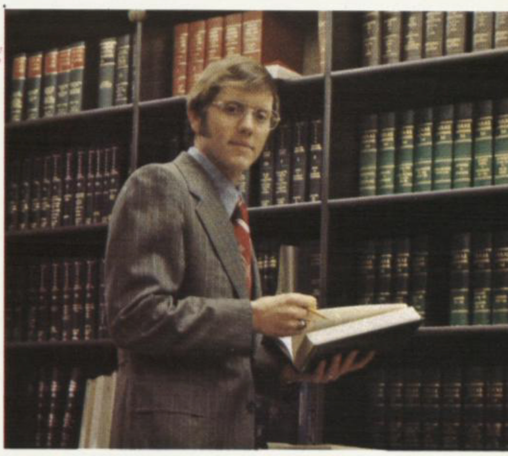

Jerry Tinkle


John A. Spillman

Larry G. Hood



Raymond E. Kelly



Arthur R. Snyder

F. J. Spillman
Chairman of the Board, President and Chief Executive Officer

Larry G. Hood
Vice President — Finance

Raymond E. Kelly
Vice President — Administration

M. R. MaGouirk
Vice President — Operations

George W. Wragg
Vice President — Distribution

Walter J. Sodeman
Vice President — Franchising

Arthur R. Snyder
Secretary and Corporate Counsel

James A. Rozzell
Controller

Jerry Tinkle
Director of Operations

James M. Phy
Director of Real Estate

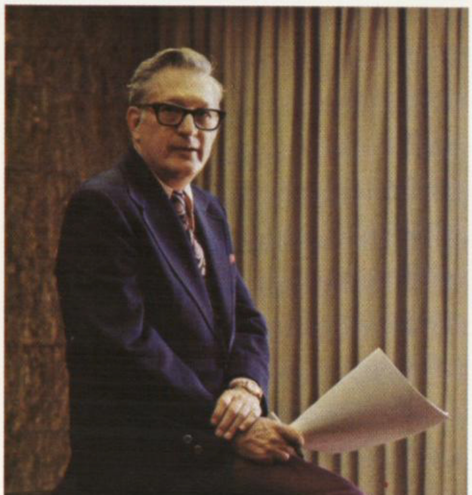
Raymond L. Champoux
Director of Franchise Services

John A. Spillman
Director

Roy L. Wise, Sr.
Director

Raymond L. Champoux

Roy L. Wise, Sr.



NORCO MANUFACTURING AND DISTRIBUTING COMPANY

A Division of The Pizza Inn, Inc.

Norco is the warehousing and distribution division of The Pizza Inn, Inc. and provides a steady flow of supplies and goods on a regular schedule to Company units and franchised Pizza Inns.

With six trucks, both long distance and local, Norco is able to make direct deliveries to more than 80% of all Company stores and most franchised stores located in Texas, Oklahoma, Kansas, Missouri and Louisiana.

During 1973, the impact of unprecedented increases in the cost of foods was felt by all segments of our economy; however, because of Norco's buying power and ability to purchase supplies in bulk quantities, your Company was able to take advantage of volume discounts.

Norco's sales to franchisees for 1973 were \$1,938,000, which represents a 164% increase over 1972 sales. As the Company's sales increase, additional purchasing power will be generated from which the entire Pizza Inn chain can benefit.

Norco is in the process of converting all of its inventory control and accounting procedures to computerized operations which should increase the effectiveness of Norco's accounting procedures. In 1974, plans are to double the size of Norco's existing facilities with the construction of a new warehouse. As new Pizza Inns are opened, Norco will be ready to serve them quickly, efficiently and with the lowest available costs.

WHAT IS PIZZA INN?

PIZZA INN IS A SATISFIED CUSTOMER.

It's a concept, a creation. It's people working together. It's a product and it's a smile.

Pizza Inn is hundreds of people.
Managers, investors, administrators, waitresses, cooks, secretaries, accountants, supervisors, contractors, warehousemen and truck drivers. It's advertisers and paper work. It is a CUSTOMER, a GUEST.

It is answering a telephone and helping a customer. It's more than taking an order — it's filling a desire. It's saying "How are you today," and really meaning it.

Pizza Inn is a distinctive restaurant. It's a beverage and a Giant sausage and onion. It's a place for you, your family and friends. Pizza Inn is personal and intimate.

It's a waitress who had a bad day but does not show it to her customers.

Pizza Inn is a warehouse with delivery schedules to keep. It's franchisees wanting new stock lists and placemats. It's produce deliveries and fresh batches of dough. It's bags of secret spices and bottles of special salad dressing.

What is Pizza Inn? It's dedicated men and women and customers and waitresses who know each other's name.

It is a waitress explaining a product to a new customer. It's a dinner-time rush with a dining room full of people. It's bussing tables and refilling drinks. Pizza Inn is serving people.

Pizza Inn is franchisees who want advertis-

ing materials. It's new areas and new stores. It's Company assistance and royalty checks. It's hard work and it is rewards. It's teaching a new franchisee or a new Company employee the Pizza Inn way.

Pizza Inn is a newspaper ad; a radio or television commercial. It's a quality restaurant in more than 30 states, Mexico and Japan. It's a team effort — both franchisee and Company. It's a chain of more than 260 restaurants.

It's four sizes of pizza with endless varieties. It's a small, medium, large or giant. It's spaghetti and sandwiches and salads. It's a meeting place after the football game and a place for a midnight snack. It's more than a place to eat — it's a store full of people and a store opening on schedule.

Pizza Inn is accountants and computers. It's "Looking Inn" magazine. It's a managers' meeting or a store's meeting. It's staying up late at night preparing for tomorrow's business. It's weekly inventories and weekly reports.

It's doing something right and being told about it. It's doing something wrong and doing something about it. Pizza Inn is a lunch buffet; it's a nutritious meal. It's franchisees wanting location approval. It's Operating Manuals and direct mail programs. It's a continuing advertising program.

Pizza Inn is bank deposits. It's a publicly-held corporation. It's listening to compliments and complaints; it's making improvements. Pizza Inn is ovens and dough-rollers. It's slicing cheese and making sauce. Pizza Inn is caring about service and people. It's a warmly lighted building sign glowing a friendly welcome.

Pizza Inn is dedicated people. It's a loyal customer and a new customer. It's hard workers who care. Pizza Inn is a tradition. It's a way of life. It's America's favorite pizza.

Pizza Inn is different things to different people.

PIZZA INN IS PEOPLE.

CONSOLIDATED BALANCE SHEET

ASSETS

	December 31 1973	1972
CURRENT ASSETS		
Cash	**$ 1,205,998**	$ 716,645
Receivables — Note G:		
Trade accounts	**463,392**	106,144
Equipment contract installments less unearned discounts (1973 — $10,192; 1972 — $14,445)	**48,166**	165,542
Allowance for doubtful accounts (deduction)	**(20,000)**	(20,000)
	491,558	251,686
Deferred income taxes	**123,200**	118,500
Inventories	**1,006,967**	361,808
Property held for resale	**266,649**	266,649
Prepaid expenses	**53,204**	34,612
TOTAL CURRENT ASSETS	**3,147,576**	1,749,900
OTHER ASSETS		
Due from officers and directors	**47,222**	26,663
Equipment contract installments due after one year less unearned discounts (1973 — $13,416; 1972 — $72,402) — Note G	**57,883**	178,555
Lease and utility deposits and other	**138,751**	98,463
	243,856	303,681
PROPERTY AND EQUIPMENT — Note D		
Land (1973 — $771,916; 1972 — $683,906) and buildings	**2,144,522**	1,871,685
Leasehold improvements	**638,584**	467,697
Fixtures and equipment	**2,903,721**	2,260,086
Allowances for depreciation (deduction)	**(1,252,016)**	(912,174)
	4,434,811	3,687,294
INTANGIBLES — Note C	**1,311,675**	1,360,283
	$ 9,137,918	$ 7,101,158

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31 1973	1972
Current Liabilities		
Trade accounts payable	$ 804,179	$ 336,663
Accrued compensation and related taxes	247,588	229,070
Other accrued expenses	614,265	489,178
Federal and state income taxes	461,344	378,000
Current maturities of long-term debt less related deferred interest (1973 — $74,165; 1972 — $102,191)	347,615	362,631
Total Current Liabilities	2,474,991	1,795,542
Long-Term Debt — less related deferred interest (1973 — $115,922; 1972 — $83,618) and current maturities — Note D	1,200,851	935,374
Deferred Income	133,022	134,851
Stockholders' Equity — Note E		
Common Stock — par value $1 a share: Authorized — 5,000,000 shares Issued: 1973 — 1,499,843 shares (including 22,950 shares held in treasury); 1972 — 1,455,393 shares	1,499,843	1,455,393
Additional paid-in capital	2,712,455	2,583,924
Retained earnings	1,223,586	196,074
Cost of Common Stock in treasury (deduction)	(106,830)	—
	5,329,054	4,235,391
Commitments and Contingent Liabilities — Notes H and I		
	$ 9,137,918	$ 7,101,158

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF EARNINGS

	Year ended December 31 1973	1972
Net sales	**$20,458,549**	$13,874,984
Monthly franchise royalties	**601,821**	462,622
Initial franchise fees	**59,650**	28,250
Other operating income	**168,011**	202,781
TOTAL REVENUE	**21,288,031**	14,568,637
Costs and expenses:		
Cost of goods sold	**14,651,830**	10,161,342
Selling, administration, and general	**4,512,345**	3,148,558
	19,164,175	13,309,900
	2,123,856	1,258,737
Interest income	**26,051**	32,553
	2,149,907	1,291,290
Interest expense — principally on long-term debt	**208,095**	198,082
EARNINGS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM	**1,941,812**	1,093,208
Income taxes — Note F		
Currently payable	**919,000**	624,000
Deferred (credit)	**(4,700)**	(118,500)
	914,300	505,500
EARNINGS BEFORE EXTRAORDINARY ITEM	**1,027,512**	587,708
Extraordinary item — Note F	**—**	215,000
NET EARNINGS	**$ 1,027,512**	$ 802,708
Per share — Note A:		
Earnings before extraordinary item	**$ .68**	$ .40
Extraordinary item	**—**	.14
Net earnings	**.68**	.54

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Year ended December 31 1973	1972
COMMON STOCK		
Balance at beginning of year	$ 1,455,393	$ 1,521,765
Exercise of stock options — Note E	43,450	—
Issued for purchase of certain assets (1,000 shares)	1,000	—
Cancellation of Common Stock in treasury	—	(66,372)
BALANCE AT END OF YEAR	$ 1,499,843	$ 1,455,393
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of year	$ 2,583,924	$ 2,647,702
Issuance of Common Stock upon exercise of stock options and related tax benefit of $90,305 — Note E	120,531	—
Issuance of Common Stock for purchase of certain assets (1,000 shares)	8,000	—
Issuance of Common Stock in treasury upon exercise of stock options and related tax benefit of $31,000	—	22,735
Issuance of Common Stock in treasury for acquisition — Note B	—	12,804
Issuance of Common Stock in treasury in settlement of indebtedness	—	4,260
Cancellation of Common Stock in treasury	—	(103,577)
BALANCE AT END OF YEAR	$ 2,712,455	$ 2,583,924
RETAINED EARNINGS (Deficit)		
Balance at beginning of year	$ 196,074	$ (606,634)
Net earnings	1,027,512	802,708
BALANCE AT END OF YEAR	$ 1,223,586	$ 196,074
COMMON STOCK IN TREASURY		
Balance at beginning of year	$ —	$ 239,525
Cost of 22,950 shares purchased	106,830	—
Exercise of certain stock options (19,000 shares)	—	(48,640)
Issued for acquisition (4,178 shares) — Note B	—	(10,696)
Payment of certain indebtedness (4,000 shares)	—	(10,240)
Cancellation (66,372 shares)	—	(169,949)
BALANCE AT END OF YEAR — Note J	$ 106,830	$ —

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31 1973	1972
SOURCE OF FUNDS		
From operations:		
Earnings before extraordinary item	$ 1,027,512	$ 587,708
Charges not requiring current outlays of working capital (credits):		
Depreciation	339,842	313,756
Amortization	34,076	32,691
Decrease in deferred income	(1,829)	(13,959)
Total from operations before extraordinary item	1,399,601	920,196
Extraordinary item — Note F	—	215,000
TOTAL FROM OPERATIONS	1,399,601	1,135,196
Decrease in other assets	—	53,585
Payments received on equipment contracts	156,279	247,263
Decrease in intangibles	14,532	—
Proceeds from long-term borrowing, less refinancing of $97,000 in 1972	615,350	528,000
Issuance of Common Stock	172,981	109,375
	$ 2,358,743	$ 2,073,419
APPLICATION OF FUNDS		
Additions to equipment contracts receivable	$ 35,607	$ 66,068
Increase in other assets	60,847	—
Business purchased in 1972:		
Property acquired at fair value		80,752
Goodwill		74,896
Long-term debt assumed (deduction)		(132,148)
		23,500
Additions to property, plant and equipment including reclassification from Property Held For Resale of $859,101 in 1972, less carrying value of assets sold or retired (1973 — $41,311; 1972 — $91,764)	1,087,359	1,005,706
Reductions of long-term debt	349,873	512,876
Acquisition of Common Stock for treasury	106,830	—
Increase in working capital	718,227	465,269
	$ 2,358,743	$ 2,073,419
CHANGES IN WORKING CAPITAL		
Increase (decrease) in current assets:		
Cash	$ 489,353	$ 621,261
Receivables	239,872	374
Deferred income taxes	4,700	118,500
Recoverable income taxes	—	(38,961)
Inventories	645,159	79,361
Property held for resale	—	(785,122)
Prepaid expenses	18,592	(4,386)
	1,397,676	(8,973)
Increase (decrease) in current liabilities:		
Notes payable	—	(113,603)
Trade accounts payable	467,516	(133,787)
Accrued liabilities	143,605	41,798
Federal and state income taxes	83,344	378,000
Current maturities of long-term debt	(15,016)	(646,650)
	679,449	(474,242)
INCREASE IN WORKING CAPITAL	$ 718,227	$ 465,269

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Two years ended December 31, 1973

Note A — Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its Mexican subsidiary. Significant intercompany accounts and transactions have been eliminated.

The financial statements of the subsidiary (see Note B) have been translated at the exchange rate at year end. The exchange rate has not changed since the date of acquisition.

INVENTORIES

Inventories, consisting of food, paper products, supplies, and equipment, are stated at the lower of cost (principally first-in, first-out method) or market.

PROPERTY AND EQUIPMENT AND DEPRECIATION

Property and equipment are stated on the basis of cost. Major renewals and betterments of property and equipment are capitalized; maintenance and repairs are charged to expense. The cost of assets sold or retired and the related accumulated depreciation are eliminated from the appropriate accounts, and the resulting gain or loss is included in operations.

Provisions for depreciation of property and equipment are computed using the straight-lin method. Estimated useful lives of property and equipment on which depreciation is based follows:

Buildings	20 to 30 years
Leasehold improvements	10 years (lease term if less)
Fixtures and equipment	3 to 10 years

INTANGIBLES

Costs of reacquired rights to sell Pizza Inn franchises and cost in excess of net assets of businesses acquired prior to November 1970 are not being amortized as, in the opinion of management, there has been no diminishment in value.

Costs assigned to franchise territorial rights retained at the time of sale of certain operating locations in 1971 and costs in excess of net assets of a business purchased in 1972 are being amortized over twelve years and eight years, respectively.

FRANCHISE FEES AND ROYALTIES

Initial franchise fees are included in income when (1) such fees have been fully collected and the related restaurants have opened for business or (2) the franchises have expired and the franchisees have forfeited their fees and related rights. Royalties are accrued based on sales by franchisees.

PROMOTIONAL COUPONS

Discounts arising from redemption of promotional discount coupons are included in selling, general, and administrative expenses.

INCOME TAXES

Deferred income taxes are provided for timing differences between financial and tax reporting.

Investment tax credits are taken into income as a reduction of the provision for federal income taxes during the year in which such credits are used.

EARNINGS PER SHARE

Earnings per common and common equivalent share are based on the weighted average number of common shares and common equivalent shares outstanding (1973 — 1,508,674; 1972 — 1,487,498 shares). Common equivalent shares include those issuable on the exercise of dilutive stock options and stock purchase warrants (after reduction for common shares assumed to have been purchased with the proceeds).

Note B — Acquisition

As of May 1, 1972, the Company purchased Excalibur, S.A. De C.V., a Mexican corporation, which operates a Papa's Pizza Parlor in Monterrey, for 4,178 shares of Common Stock (aggregate value $23,500). The relatively insignificant results of

operations of the subsidiary since acquisition are included in the consolidated finanical statements.

The cost of the subsidiary in excess of net assets acquired has been included in intangibles in the consolidated balance sheet and is being amortized over the remaining term of the related real estate lease.

Note C — Intangibles

A summary of intangible assets follows:

	1973	1972
Reacquired sole and exclusive rights to sell Pizza Inn franchises — not being amortized	$ 998,000	$ 998,000
Franchise territorial rights retained in connection with the sale of certain operating locations during 1971 — unamortized portion	240,984	265,000
Excess of cost over fair value of net assets purchased — unamortized portion	72,691	97,283
	$1,311,675	$1,360,283

Note D — Long-Term Debt

A summary of long-term debt follows:

	1973	1972
Realty notes, 7% to 10%, payable in monthly installments of $13,613, with land and buildings carried at $1,508,857 at December 31, 1973 mortgaged as collateral	$ 890,938	$ 807,132
Equipment notes, 8% to 12%, payable monthly (generally over 42 to 60 months) collateralized by security agreements covering a major portion of equipment	657,528	490,873
	1,548,466	1,298,005
Less current maturities classified as current liabilities	347,615	362,631
	$1,200,851	$ 935,374

As of December 31, 1973, maturities of long-term debt are: 1974 — $347,615, 1975 — $267,325, 1976 — $178,231, 1977 — $128,775, 1978 — $111,896, and thereafter $514,624.

Note E — Stock Options and Stock Purchase Warrants

Outstanding options under both qualified and non-qualified plans are at market prices at dates of grant. Subject to termination of employment, options expire five years from the date of grant; they are exercisable over a period of five years from dates of grant and are non-transferable other than upon death. At December 31, 1973, there were Common Stock options outstanding as follows:

	No. of Shares	Option Price Per Share
Qualified Plan	43,100	$2.125 to $9.000
Non-Qualified Plan	18,500	2.125 to 6.125
	61,600	

All options granted under the non-qualified plan and options for 9,338 shares under the qualified plan were exercisable at December 31, 1973.

Stock options were exercised or cancelled during the year, as follows:

	Qualified Plan		Non-Qualified Plan	
	No. of Shares	Option Price Per Share	No. of Shares	Option Price Per Share
Exercised	250	$2.125	43,200	$1.35 to $2.35
Cancelled	1,800	$4.00 to $9.00	7,000	$6.125
	2,050		50,200	

In connection with a bank loan during December 1972, a Common Stock Purchase Warrant for 20,000 shares of Common Stock at $8.25 a share was issued to the bank. The Warrant is exercisable in whole or in part until its expiration in December 1984.

See Note H with regard to a Common Stock Purchase Warrant issued to Underwriters in connection with a public offering in 1969.

In connection with the purchase of certain assets in 1973, an option to purchase 1,000 shares of Common Stock at $4.625 per share was granted the seller. The option is exercisable during 1974, provided certain earnings are achieved by the acquired restaurants. Based upon current results, the Company's management believes the earnings requirement will not be achieved.

At December 31, 1973, a total of 159,250 shares were reserved for stock options and outstanding warrants.

Note F — Income Taxes

As a result of its 1971 and 1970 operations, the

Company had ordinary operating loss carryforwards of approximately $368,000 and investment credit carryforwards of approximately $39,000; these carryforwards were used in full in 1972. The resulting reduction in income taxes of $215,000 is shown as a 1972 extraordinary item.

The consolidated effective income tax rate is less than the statutory rate, principally because of the effect on the rates of amortization of intangible assets and investment credit. It is expected that income taxes payable during 1974, 1975, and 1976 will not substantially exceed total income tax expense for such years.

Investment tax credits amounted to $38,516 and $7,887 in 1973 and 1972, respectively.

Note G — Due From Officers and Directors

Equipment Contracts Receivable include $65,451 and $153,954 due from officers and directors at December 31, 1973 and 1972, respectively. Such indebtedness results principally from the sale of several operating restaurants to these individuals in 1970 and 1971.

Note H — Leases and Other Commitments

Substantially all of the real property occupied by the Company is leased for terms ranging from 5 to 20 years, with renewal options ranging from 10 to 20 years. Most of the lease agreements contain contingency provisions requiring additional rental based upon sales volume.

Financing leases, shown below, include leases which during the noncancellable lease period (excluding renewal periods) cover 75% or more of the economic life of the property leased or assure the lessor a full recovery of the fair market value of the property plus a reasonable return on investment. All operating restaurants being leased by the Company have been determined to be financing leases.

Total rental expense for all leases is as follows:

Financing leases:		
Minimum rentals	$ 960,702	$ 824,828
Subleases (deduction)	(23,376)	(9,660)
	937,326	815,168
Contingent rentals	16,815	9,457
	954,141	824,625
Other leases:		
Minimum rentals	418,597	391,904
Subleases (deduction)	(127,337)	(109,956)
	291,260	281,948
	$1,245,401	$1,106,573

Future minimum rental commitments for noncancellable leases at December 31, 1973 are as follows:

	Total	Sublease Rental (Deduction)	Financing Leases	Other Realty Leases	Equipment Leases
1974	$ 1,223,960	$(151,638)	$ 1,047,923	$ 281,983	$45,692
1975	1,196,405	(148,888)	1,039,557	281,983	23,753
1976	1,175,264	(131,338)	1,017,963	280,983	7,656
1977	1,146,739	(90,938)	981,796	251,208	4,673
1978	1,115,616	(74,172)	947,270	241,956	562
1979-1983	5,173,067	(193,980)	4,174,682	1,192,365	—
1984-1988	3,454,384	(28,995)	2,684,442	798,937	—
1989-1993	1,173,386	—	1,049,566	123,820	—
	$15,658,821	$(819,949)	$12,943,199	$3,453,235	$82,336

Included in other realty lease expense in 1973 and 1972 are rentals, excluding sublease rentals, of approximately $71,000 and $89,000, respectively, applicable to closed restaurants. A total aggregate net commitment of approximately $1,403,000 applicable to these closed operations is included in the total above. The Company attempts to renegotiate lease terms or sublease these properties when pos-

sible; however, in many instances, these are short term arrangements which do not run for the entire lease term.

The estimated present values of the net minimum rental commitments for all non-cancellable financing leases are as follows:

	Range of Interest Rates Used	December 31 1973	1972
Operating restaurants	6% to 10.5%	$7,688,321	$7,024,496
Subleases	7%	$ 194,716	$ 204,047

If all financing leases had been capitalized, it is estimated that net income for 1973 and 1972 would have been reduced by $95,349 and $100,956, respectively. This computation assumes that the estimated present values were amortized on a straight-line basis over the terms of the leases, and that interest expense was accrued on the outstanding lease obligations at the rates shown above. The amounts included in the computation for amortization and interest expense were $576,808 and $584,074 in 1973, and $511,320 and $517,111 in 1972.

In connection with a public offering in 1969, a Common Stock Purchase Warrant for 20,000 shares of Common Stock at $10.80 a share was issued to the Underwriters. The Company agreed that it would file, at its cost, a post-effective amendment to the Registration Statement covering the shares of Common Stock issuable upon exercise of the Warrant which will expire in July 1974.

Note I — Contingent Liabilities

The Company has guaranteed the realty lease obligations of certain franchisees and remains contingently liable on the realty leases of certain operating restaurants which have been sold; related aggregate rentals amount to approximately $483,000 annually and amount to a total aggregate contingency of approximately $5,150,000 December 31, 1973.

Lawsuits pending or threatened against the Company at December 31, 1973, involved aggregate alleged damages of approximately $293,000. The Company's legal counsel and management believe the suits comprising most of this amount to be without merit, or grossly inflated, and believe the maximum potential losses will not exceed $75,000. Provision for such expected losses has been made in the consolidated financial statements at December 31, 1973.

Note J — Subsequent Event

The Company purchased for its treasury an additional 5,800 shares of its Common Stock at a cost of $24,538 during January 1974.

ACCOUNTANTS' REPORT

Board of Directors
The Pizza Inn, Inc.
Dallas, Texas

We have examined the consolidated balance sheet of The Pizza Inn, Inc. and subsidiary as of December 31, 1973 and 1972, and the related consolidated statements of earnings, changes in stockholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accouting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of earnings, changes in stockholders' equity, and changes in financial position present fairly the consolidated financial position of The Pizza Inn, Inc. and subsidiary at December 31, 1973 and 1972, and the consolidated results of their operations, changes in stockholders' equity, and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst

February 7, 1974

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